April 30, 1998

Janet Gail Besser, Chair
John D. Patrone, Commissioner
James Connelly, Commissioner
A. Robert Keating, Commissioner
Paul B. Vasington, Commissioner
Department of Telecommunications and Energy
100 Cambridge Street, 12th Floor
Boston, MA 02202

RE: Massachusetts Gas Unbundling Collaborative – Notice of Inquiry

Dear Chair Besser and Commissioners:

El Paso Energy Marketing (EPEM) offers the following comments regarding the Department of Telecommunications and Energy's Notice of Inquiry dated April 3, 1998.

EPEM believes that a Portfolio Auction can be a successful way to maximize the benefits of the upstream capacity resources of Massachusetts LDC's. EPEM also realizes the LDC's have proposed a Portfolio Auction that incorporates a mandatory capacity-release system and that the Retail Marketers want a purely voluntary capacity release program. EPEM feels the best way to bridge the capacity release gap is to have the Wholesale Marketer(s) accept the permanent assignment of transportation and storage capacity in amounts equal to the difference between the load migrating to the Retail Marketer and the capacity permanently elected by the Retail Marketer under a voluntary capacity release system. EPEM understands that the permanent release of capacity to the market requires the Department to determine that a competitive upstream market can develop to ensure the continued availability of capacity for Massachusetts customers. If the Department feels the market for upstream capacity will be competitive and that the LDC's can safely be relieved of their responsibilities and exit the merchant function, it is possible to merge the interests of both parties under EPEM's program. The details of this program are as follows:

◊ Portfolio Auction -- National Wholesale Marketers are given the opportunity to bid for the right to manage the upstream assets of one or multiple LDC's during the transition period.
    ◊ The LDC assigns the capacity required to meet its default service to the Wholesale Marketer on a recallable basis for the term of the transition period.

- The term of the transition period should be 5 years.

◊ Capacity Election – During the transition period as customers migrate off-system, the retail marketers are given a one time election to take a prorata share of the LDC's upstream transportation and storage capacity at the applicable pipeline maximum rate.

- ◊ The capacity elected by the Retail Marketers is assigned on a **permanent** basis.
- ◊ The difference between the volume migrating to the Retail Marketers and the corresponding capacity elected by the Retail Marketers is **permanently** assigned to the Wholesale Marketer at the applicable pipeline maximum rate.

  EXAMPLE:

  Assumption 1 --The total upstream transportation held by the LDC is 100,000 Dth/d

  Assumption 2 – 10,000 Dth/d migrate to Retail Marketers

  Assumption 3 – The Retail Marketer elects to take 4,000 Dth/d of upstream capacity on a prorata basis

  Resulting Capacity Release:

  - 4,000 Dth/d is **permanently** released to the Retail Marketers
  - 6,000 Dth/d is **permanently** released to the Wholesale Marketer
  - 90,000 Dth/d remains with the LDC
- ◊ Both migrating and non-migrating customers are able to participate in the savings generated by permanently releasing capacity.
  - Migrating Customers are able to secure the lowest possible price because the Retail Marketers are not forced to take capacity they do not need to provide their service.
  - Non-Migrating Customers receive the benefits of lower gas cost resulting from the capacity optimization provided by the Wholesale Marketer and through the premium paid by the Wholesale Marketer for the permanent release of capacity (both for purposes of providing service to non-migrating customers and from un-subscribed capacity offered to migrating customers) in the Portfolio Auction.

◊ Wholesale Marketers Prohibited From Retail Sales -- To reduce the risk of excessive market power, the Wholesale Marketers and their affiliates are prohibited from offering retail services.

Portfolio Auction

If it is determined that a competitive upstream market will develop and the Portfolio Auction proposed by the LDC's is approved the Wholesale Marketer can provide the services described above. The Portfolio Auction offers the following benefits:

- ◊ The liquidity needed in the region to create a robust secondary market is facilitated when the Wholesale Marketers control the upstream transportation and storage.
  - ◊ A liquid secondary market makes it possible for Retail Marketers to adjust their upstream capacity needs without requiring the LDC's to provide a capacity clearinghouse service.
    - Liquidity in the market place allows the Retail Marketers to buy and sell capacity in an open market with other regional participants.
- ◊ Wholesale Marketers are able to optimize the LDC's upstream transportation and storage assets while providing cost savings to the non-migrating customers.
  - ◊ Economic efficiencies and cost savings are created through the Wholesale Marketer's ability to utilize financial instruments and through the expertise of their extensive marketing and trading staffs.
  - ◊ Service reliability for customers <u>not selecting</u> a retail marketer can be maintained through the cooperative efforts between the LDC and the Wholesale Marketer.

The portfolio auction combines the core competencies of the LDC and the Wholesale Marketer. The LDC determines the location and volume of gas needed to serve the default requirements customers while the Wholesale Marketer assumes the responsibility of supplying and transporting the gas to the city gate at the lowest possible cost.

Capacity Election

The Capacity Election process would be handled as follows:

- ◊ The Retail Marketers are given a one time opportunity to take **permanent** assignment of a **prorata** share of the LDC's upstream transportation and storage capacity commensurate with the load migrating to the Retail Marketer.
  - ◊ Requiring the Retail Marketer to take a prorata share of all the transportation paths assures equity in the distribution of capacity.
    - The Wholesale Marketer providing default service and the Retail Marketer have equal access to both preferred and secondary supply basins and market area delivery points.
- ◊ The Wholesale Marketers take permanent assignment of capacity not elected by the Retail

Marketers

◊ Mandating Wholesale Marketers to take permanent assignment of the capacity not elected by the Retail Marketers minimizes stranded costs and furthers the Department's goal of functionally separating the LDC's supply operations from its local distribution services.

- Long term access to transportation capacity increases the value of the Portfolio Auction because it gives the Wholesale Marketer the ability to market bundled sales well beyond the transition period.
  - ⇒ Without the permanent assignment, the Wholesale Marketer is limited to transactions that fall within the scope of the transition period.
- Allowing the LDC's to permanently assign their upstream capacity takes the job of coordinating the 'ebb and flow' of the Retail Marketer's volume from the LDC and places it in the open market.
  - ⇒ This creates a further separation of the LDC's supply and distribution functions.

A liquid secondary transportation market can only be established if capacity is released on a permanent basis. Adding a recall option to a transportation transaction reduces the capacity value and slows down the transition to a fully competitive market place.

Once a liquid transportation market is developed, all available capacity within Massachusetts can be directed to the highest value market. Unrestricted transportation resulting from the permanent release of capacity will allow growth areas within Massachusetts to access the available capacity of all the LDC's within the state. Without a permanent capacity release mechanism, the firm capacity available to serve growth is limited to the existing capacity available to the service territory where the growth is occurring. Capacity optimization occurs because the permanent assignment allows the retail and wholesale marketers to change the primary delivery points in the upstream transportation contracts.

When the primary delivery points of a downstream LDC are moved to an upstream LDC there is a risk that growth in the downstream LDC will be hampered because of the reduction of primary firm capacity available to its city gate. This situation, although plausible, may be reduced in Massachusetts as liquidity is developed in the marketplace. Additional reasons why this is improbable are as follows:

- ◊ Without forward haul sources of supply between LDC's, shippers are not incented to contract for short haul transport with a receipt point at the upstream LDC's city gate and a delivery point at the downstream LDC's city gate.
  - ◊ The ability to move primary delivery points back and forth throughout the state is viable as long as the capacity between LDC's is un-subscribed.
  - ◊ When new forward haul sources of supply are operational they will, by definition, provide additional upstream capacity to replace any potential loss of upstream Long Haul Gulf of Mexico capacity resulting from changes in primary delivery points.
- ◊ The permanent assignment of capacity facilitates the development of a liquid secondary market. Liquidity in the transportation market reduces the risk of upstream firm capacity shortfalls hampering growth within a downstream LDC's service territory.

Wholesaler Marketers are Prohibited From Retail Operations

Wholesale Marketers should not be allowed to participate at the retail level. Allowing the Wholesale Marketers to compete in retail simply recreates the existing scenario where the owner of the upstream capacity is expected to fill the dual and conflicting role of fostering competition while trying to maintain its own market share. Without separating the wholesale marketing from retail marketing the rate payer gets an unregulated monopoly under the guise of unbundling.

DEVELOPMENT OF A COMPETITIVE GAS RETAIL MARKET

The process described above supports the development of a competitive gas retail market by providing the following benefits:

- ◊ Both migrating and non-migrating customers are able to participate in the savings generated by unbundling. Migrating customers receive a lower gas price because the Retail Marketers are not saddled with unneeded capacity while Non-migrating customers benefit from the cost reductions and premiums generated by the Portfolio Auction.
  - ◊ A robust secondary market is encouraged because the Wholesale Marketers, Retail Marketers, and the LDC's are all incented to increase throughput.

- The Wholesale Marketers want to increase throughput to increase liquidity.
  - ⇒ Liquidity is required for the Wholesale Marketer to generate a profit from its existing assets and the assets it controls via the Portfolio Auction.
    - * Liquidity is fostered when the Wholesale Marketer is prohibited from participating in the Retail Market.
    - * An upstream capacity holder that is no longer competing in the retail market is incented to create a robust market with many market participants.
- The Retail Marketers want to increase throughput and liquidity to generate additional revenue.
- The LDC's want to increase throughput to maximize transportation revenue and to develop new gas markets.

COMPETITIVE BENEFITS

The competitive benefits derived from this methodology are seen in both the avoidance of past commitments and from savings due to forward looking efficiencies. The primary avoided cost is derived by mitigating the stranded cost associated with upstream pipeline storage and transportation demand charges. On a forward looking basis, the cost to migrating customers is reduced because the Retail Marketers are not required to take more capacity than they need to provide their service while the Non-migrating customers derive the cost savings through the LDC Portfolio Auction.

SUMMARY

The permanent release of upstream capacity is consistent with the development of a competitive market for upstream capacity resources. The Department should agree that sufficient competition exists to allow the LDC's to ease out of the merchant function via the gradual permanent release of upstream capacity to retail and wholesale marketers during the transition period. The proposal outlined above by EPEM is an appropriate option and meets the criteria originally set out by the Department.

◊ This proposal fosters **Customer Choice** and **Ensures All Customers Have the Opportunity to Enjoy the Benefits of Competition** by providing benefits to both migrating and non-migrating customers.

- ◊ Migrating customers enjoy the benefits of lower gas cost created through competition.
- ◊ Non-Migrating customers receive lower gas cost through the competitive structure of the Portfolio Auction and through the asset management expertise of the Wholesale Marketer.

◊ EPEM believes separating the role of the Wholesale and Retail Marketers is the key to **Encouraging Fair and Full Competition**. Without the Wholesale/Retail separation, the holder of the capacity is charged with the conflicting goal of encouraging competition while trying to maintain its own market share.

◊ **Functionally Separating the LDC's Supply Operations from the Local Distribution Services** is an important strength of this proposal. Under this proposal the LDC's are no longer responsible for managing the transportation requirements of the Retail Marketers. Through a permanent assignment of the migrating customer's capacity to either the Retail Marketer or the Wholesale Marketer, a robust and liquid secondary market is created. Once an adequate secondary market is functioning it is no longer necessary for the LDC to assign, recall, and reassign capacity as the market share of each individual Retail Marketer changes.

Sincerely,
EL PASO ENERGY MARKETING

Steve Durio
Managing Director, Northeast Marketing